BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
BENEFICIAL FINANCE CO. OF ALAMEDA)
AND AFFILIATES)

Appearances:

For Appellant: George R. Richter, Jr., and
John L. Kelly, Attorneys at Law

For Respondent: John J. Campbell, Executive Officer;
Burl D. Lack, Chief Counsel;
Crawford H. Thomas, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Beneficial Finance Co. of Alameda and Affiliates to proposed assessments of additional franchise tax in the total amounts of $2,964.32 and $9,259.46 for the taxable years 1951 and 1952, respectively.

During the period in question, Beneficial Finance Co. owned all the shares of approximately 600 corporations which were engaged in the small loan business. The subsidiaries operated 713 places of business in 46 states and Canada. Each subsidiary except one maintained but one or two places of business and made loans in a relatively small area. Each had a local office manager, or managers, who exercised control over local office personnel. One of the subsidiaries, Commonwealth Loan Company, had approximately 90 places of business in 10 states, including California. Fifty-seven of these subsidiaries were engaged in the small loan business in California and were licensed under the Personal Property Brokers Law.

Beneficial Finance Co. also owned all the shares of Beneficial Management Corporation of America, which did business in California and elsewhere. This corporation performed management services for the operating subsidiaries. The services included auditing, advising, interpreting policy and recruiting managers. It charged the operating subsidiaries its actual cost of providing the services and this charge was prorated among the subsidiaries on the basis of loans outstanding.

Beneficial Finance Co. set the policies for all of its subsidiaries. It obtained funds by borrowing from banks and

issuing debentures and loaned to the subsidiaries the funds which they in turn loaned to their customers. There were group insurance and pension plans for the entire Beneficial Finance system and the benefits were available to employees of the subsidiaries. An integrated training program was carried on for all employees. There was national advertising of the system. Personnel were interchanged between the various corporations.

The 58 subsidiaries engaged in business in California filed franchise tax returns and, with the exception of Commonwealth Loan Company, computed their net income by separate accounting. Commonwealth Loan Company allocated a portion of its income to California by use of a formula consisting of the factors of (1) tangible assets, (2) wages and salaries and (3) gross interest income.

Respondent concluded that the business of Beneficial Finance Co. and its subsidiaries was unitary and combined their entire income. By a three-factor allocation formula, Respondent determined that 8.0586% of the combined net income was derived from or attributable to sources in California. This amount was $1,717,993.33. The three factors used were (1) average loans outstanding, (2) wages and salaries and (3) interest income. Those corporations engaged in business in California agreed with Respondent that for convenience the resulting deficiency could be assessed in the name of "Beneficial Finance Co. of Alameda and Affiliates."

Appellants protest the determination of California net income by a formula. They contend that the business of the various corporations was not unitary in nature.

The organization and operation of Beneficial Finance Co. and its subsidiaries is substantially identical to the organization and operation of American Investment Company and its subsidiaries which we held to be unitary in Appeal of Public Finance Co., Cal. St. Bd. of Equal., Dec. 29, 1958 (2 CCH, Cal. Tax Cas., Par. 201-205), (2 P-H State & Local Tax Serv., Cal., Par. 13,194.) As we stated in that opinion:

> It is readily apparent that the purpose and necessary effect of central procurement of money, centralized accounting and supervision, centralized employee training programs, the management pool thereby developed, the opportunity for interchange of personnel and the common employee benefit plans which existed, were to contribute to increased earnings for the group.

* * *

> We are aware of only three cases in which courts have considered whether groups of corporations engaged in operations similar to those involved herein were engaged in unitary businesses. In each of these cases, the court held that the taxpayer was thus engaged. (Beneficial Loan Society of Oregon v. State Tax Commission, 95 Pac. 2d 429; Household Finance Corp. v. State Tax Commission, 128 Atl. 2d 640; Householdkate Tax Commission, 142 Atl. 2d 807.)

We conclude here, as we did there, that the operation of the portion of the business within the State depended upon or contributed to the operation of the business without the State and that the entire business was therefore unitary under the test laid down by the California Supreme Court in Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472.

Appellants contend that even if the business was unitary, computation of California net income by formula is improper because the maximum statutory interest rates on small loans in California are lower than those applicable to most of the offices in the Beneficial system.

This argument misconceives or ignores the concept of a unitary business and the reason for applying a formula to the income of such a business as a whole. The scope of the Beneficial operations resulted in a large volume of loans and contributed to a strong financial standing of the system, thus permitting the central procurement of funds at prime rates of interest. By spreading the costs of centralized services such as management and advertising over a large base, services of a high quality were obtainable at a relatively low expense for each component of the system. The central procurement of money at low rates and the centralized services that were performed increased the profits of each of the corporations within the framework of the entire business. Thus, each portion of the business was integrated with and affected every other portion. It is this mutual contribution and dependency that demands the application of a formula to the income as a whole and that makes separate accounting inadequate. It is no answer to say that one or more of the corporations could be eliminated without affecting the rate of interest at which money could be centrally obtained, or without materially affecting the quality or per unit cost of the centralized services. (Butler Bros. v. McColgan, 17 Cal. 2d 664, aff'd 315 U.S. 501.)

The contention raised by Appellants is much the same as one considered and rejected in John Deere Plow Co. v. Franchise Tax Board, 38 Cal. 2d 214, appeal dismissed 343 U.S. 939. The court there sustained the use of a formula composed of the factors of property, payroll and sales against the taxpayer's objection that profits in California were limited because wages and other expenses were higher in California than elsewhere. In doing so, the court observed that:

> Varying conditions in the different states wherein the integrated parts of the whole business function must be expected to cause individual deviation from the national average of the factors in the formula equation, and yet the mutual dependency of the interrelated activities in furtherance of the entire business sustains the apportionment process.

Appellants' contention is even weaker than that of the taxpayer in the John Deere case. There, the high wages were reflected in the payroll factor and tended to assign more, rather than less taxable income to California. Here, the factor of interest income in the formula gives recognition to the statutory limits on interest rates, correspondingly tending to reduce the income attributed to this State.

The disparity in allowable interest rates, moreover, does not establish that the operations of the Beneficial system in other states were more profitable than its operations in California. Appellant has pointed out in another connection that loans of up to $5,000 are allowed by statute in California, while the limit is $500 in practically all other states. A higher limitation on loans not only permits increasing the gross income but also makes possible the reduction of expenses attributable to a given dollar volume of loans. Additionally, the per capita income and purchasing activity in California substantially exceed the national average and the large population here is mainly concentrated in urban areas. These are elements that may well have resulted in a greater effective demand for loans, greater economy of operation and opportunity for profits through concentration of customers, and a lower percentage of losses than in other states where the interest rates were higher.

It is well settled that once the business is found to be unitary, the Franchise Tax Board's use of an allocation formula is presumptively correct and the burden is on the taxpayer to make oppression manifest by clear, cogent evidence. (Butler Bros. v. McColgan, supra.) We have previously sustained the application to unitary finance businesses of the formula applied here by the

Franchise Tax Board. (Appeal of Public Finance Co., supra; Appeal of Tri-State Livestock Credit Corp., April 4, 1960(3 CCH State Tax Rep., Cal., Par. 201-533), (2 P-H State & Local Tax Serv., Cal., Par. 13,219.) We have nevertheless thoroughly considered all of the contentions directed by Appellants against each of the factors in the formula and will briefly discuss those upon which Appellants appear to place their primary reliance.

Appellants argue that the use of average loans outstanding is improper because California permits larger loans than other states and at lower rates of interest. The fact that California permits larger loans than other states in no way militates against the propriety of the factor in question. In so far as interest rates are concerned, Appellant's argument is answered by John Deere Plow Co. v. Franchise Tax Board, supra, and our foregoing discussion of that case.

In addition, Appellants argue that the factor of interest income is improper because of the interest rate restrictions in California. Since this factor reflects the rates of interest, the argument supports rather than undermines its use.

Finally, Appellants attack the use of wages as a factor. The appropriateness of this factor of the formula is established by all of the decisions of the California Supreme Court that we have cited herein. The gist of Appellant's position is, however, that each dollar of wages paid to management produces more income than the same amount paid to operating personnel and that most of the managing personnel are outside of California. Assuming that Appellants' basic premise concerning productivity is correct, this is a refinement which need not be reflected in the formula. In allocating income by a formula, rough approximation rather than precision is sufficient. (El Dorado Oil Works v. McColgan, 34 Cal. 2d 731, appeal dismissed 340 U. S. 801, 885.)

It is our conclusion, based upon all of the facts and arguments presented, that the action of the Franchise Tax Board must be sustained.

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Beneficial Finance

Co. of Alameda and Affiliates to proposed assessments of additional franchise tax in the total amounts of $2,964.32 and $9,259.46 for the taxable years 1951 and 1952, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of June, 1961, by the State Board of Equalization.

John W. Lynch, Chairman

Paul R. Leake, Member

Richard Nevins, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary